WHY IT MAY BE THE WRONG TIME TO EXIT EMERGING MARKETS

After the strong recovery that started in early 2016 and lasted for nearly two years, emerging market equities have lagged in recent months. The prospect of worsening trade relations, faster interest rate hikes by the U.S. Federal Reserve, and political risks in select emerging countries have made some investors more cautious. While some of these fears are real, we believe the meaningful improvement in emerging market fundamentals should outweigh the downside risks in the medium to long term.

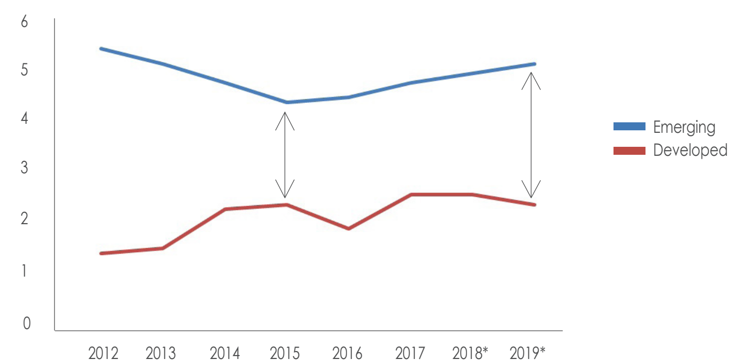
KEY TAKEAWAYS

The prospect of worsening trade relations, faster interest rate hikes by the U.S. Federal Reserve, and political risks in select emerging countries have made some investors more cautious. While some of these fears are real, we believe the meaningful improvement in emerging market fundamentals should outweigh the downside risks in the medium to long term.

GROWTH DIFFERENTIAL WITH THE DEVELOPED WORLD IS WIDENING

By most estimates, the growth upswing in emerging economies is at a relatively early stage when compared to the developed countries. Since 2016 the aggregate GDP growth differential between emerging countries and developed countries has been widening. The International Monetary Fund (IMF) estimates emerging market GDP growth to average nearly 5% in 2018 and 2019, while the developed world is expected to expand at less than half that pace.

EM: DM ECONOMIC GROWTH DIFFERENTIAL WIDENING



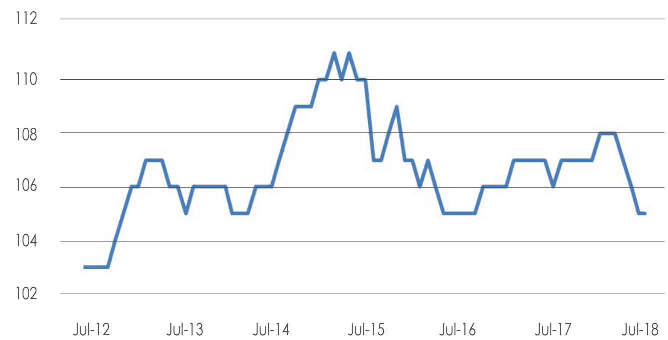
AGGREGATE ANNUAL GDP GROWTH RATES IN PERCENTAGE

*Data for 2018 and 2019 are forecasts
Data source: IMF WEO July 2018

If global trade volumes weaken, as some fear, it is likely that the emerging economies will be hurt disproportionately. However, governments in most large emerging countries have enough resources to support domestic demand and potentially prevent a further slowdown. The recently announced additional fiscal spending by the Chinese government and indirect tax cuts in India are countering the weaker external demand outlook. In addition, central banks in most large emerging countries also have the flexibility to lower interest rates if needed.

EM CURRENCIES LIKELY TO STABILIZE AS LEVERAGE FALLS

NEAR 5 - YEAR LOW FOR EM CURRENCIES LIMITS DOWNSIDE



JP MORGAN EM REAL BROAD EFFECTIVE EXCHANGE RATE, MONTHLY

Data source: Bloomberg

Notwithstanding concerns of worsening trade relations, the recently announced additional fiscal spending by the Chinese government and indirect tax cuts in India are countering the weaker external demand outlook.

The U.S. Dollar's relative strength, on expectations of more Fed rate hikes, have hurt emerging market assets recently. However, most emerging market currencies are relatively inexpensive and are close to a five-year low relative to the dollar. That should limit further downside, though select emerging countries with large current account deficits and external debts could see their currencies remaining weak.

Investors have also become more cautious about higher debt levels in emerging countries. Recent data suggest that leverage has stabilized or is falling, especially in cyclical sectors that are seeing higher price realizations and cash flows.

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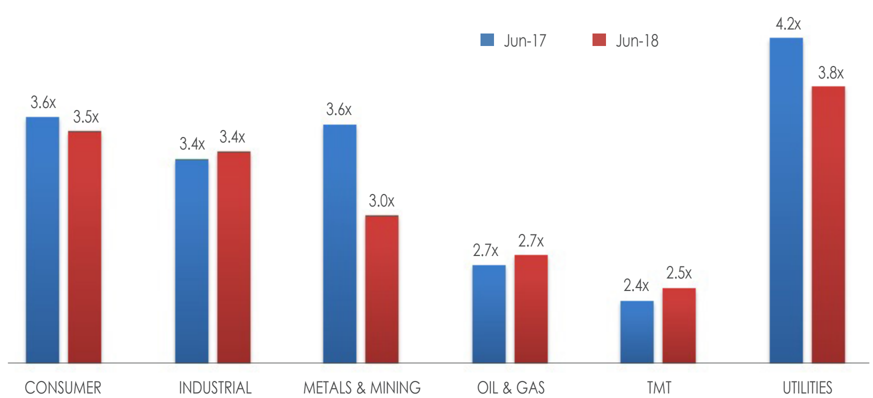
EM FINANCIAL LEVERAGE STABLE OR IMPROVING

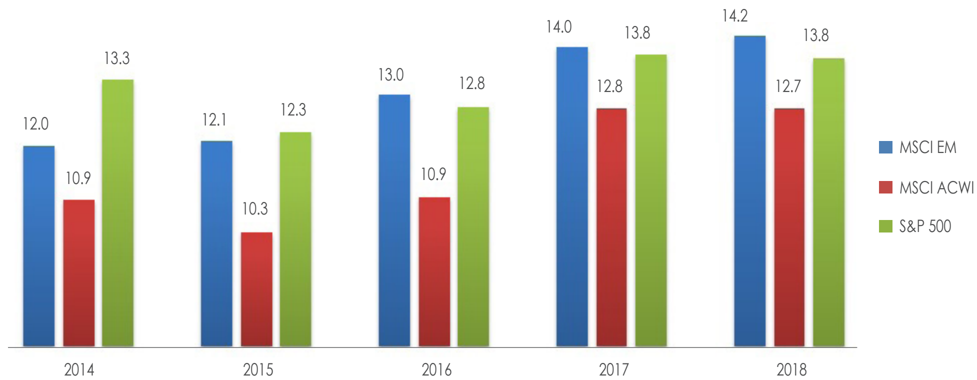


GROSS LEVERAGE BY SECTOR

Data source: Bloomberg

EM CORPORATIONS ARE MORE PROFITABLE WITH IMPROVING RETURN RATIOS AND YIELDS

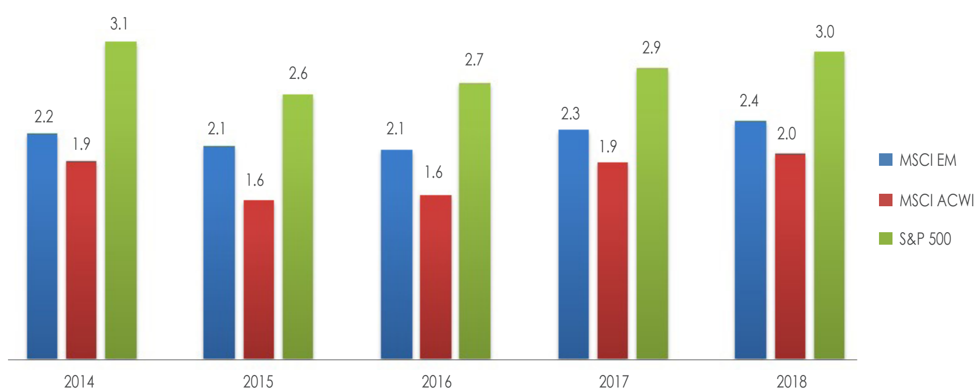
EM OPERATING MARGINS NOW EXCEED S&P 500



AVERAGE TRAILING 12 - MONTH OPERATING MARGIN FOR INDEX CONSTITUENTS

Data source: Bloomberg

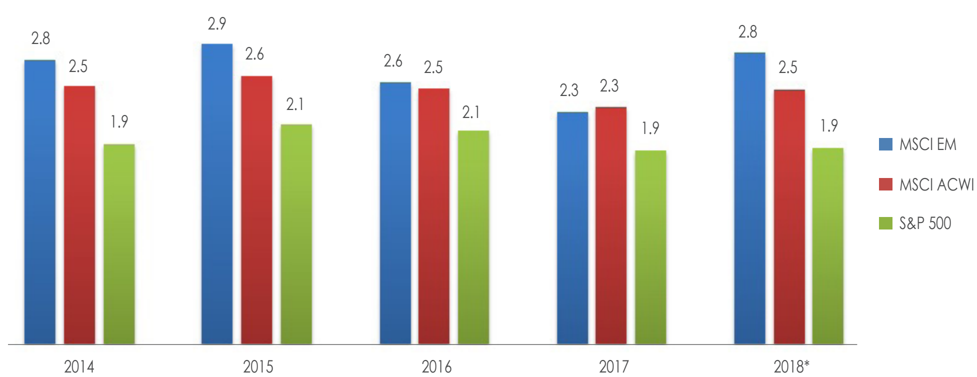
RETURN ON ASSETS HAVE IMPROVED IN EM



AVERAGE RETURN ON ASSETS FOR INDEX CONSTITUENTS

Data source: Bloomberg

DIVIDEND YIELDS HIGHER IN EM



AVERAGE GROSS DIVIDEND YIELDS FOR INDEX CONSTITUENTS

*Data for 2018 is estimate

Data source: Bloomberg

Despite improved fundamentals, emerging market equity valuations are well below that of the developed markets. After the recent correction, one-year forward P/E multiple for the MSCI EM Index is about the same as it was in early 2016 when the asset class started the strong recovery.

Improving earnings and inexpensive valuations for emerging market equities should help offset the perceived rise in geopolitical risks. If the current fears about interest rates, currencies and global trade fade, we expect the asset class to reward patient long-term investors.

EMERGING MARKET VALUATIONS REMAIN ATTRACTIVE

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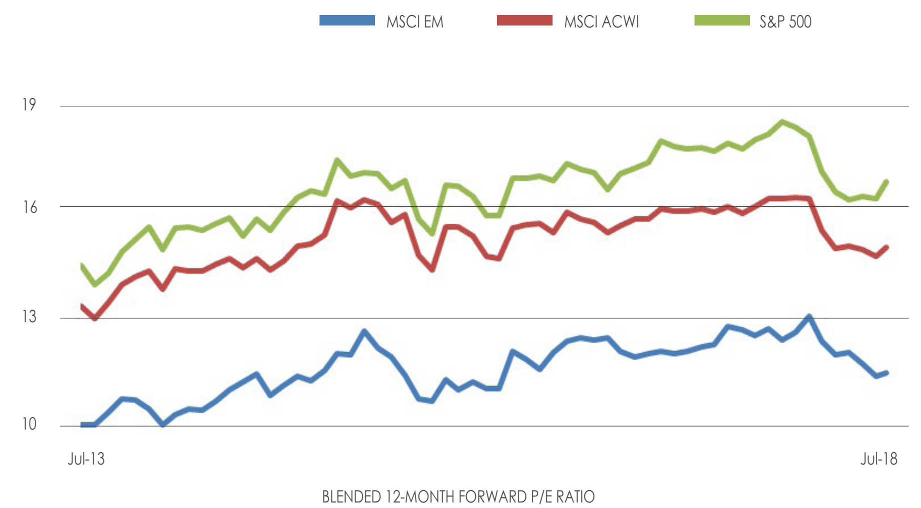
EM VALUATIONS ARE INEXPENSIVE



Data source: Bloomberg

To conclude, despite the alarming headlines about global trade wars and currency volatility, emerging market equities remain one of the more attractive choices for international investors. Improving earnings and inexpensive valuations for emerging market equities should help offset the perceived rise in geopolitical risks. If the current fears about interest rates, currencies and global trade fade, we expect the asset class to reward patient long-term investors.

Are You Positioned for a World of Opportunities?

“Our strategy is to seek smoother, more consistent returns by stressing excellent local stock selection as opposed to betting on major country and sector moves.

To succeed in this approach, we have built an exceptional global research team that uses our proprietary techniques to identify the most attractive stocks in each of the major regions of the world. This in effect is our trump card.”

— Thomas S. White, Jr., Portfolio Manager

THE THOMAS WHITE DIFFERENCE

Thomas White International manages $1.5 billion in assets across multiple global, international and domestic equity mandates. The diverse client base spans public, corporate, endowment, Taft-Hartley, and separately managed account platforms.

We use Proprietary Research. At Thomas White, we value international stocks within distinct valuation groups based on region, industry, sector, or country, which provide us with an extensive range of investment opportunities.

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